The Problem of Welfare and Efficiency

Rarely are even the most beneficial developments in human societies accomplished without either unexpected costs or unanticipated adverse consequences.

During the 1960s and early 1970s, most West European countries instituted unprecedented increases in health services, retirement pensions, educational benefits, family allowances, rent and house-owning subsidies, child-care facilities, unemployment compensation, and other forms of welfare in cash and in kind, as well as in the other services provided by governments and required of private enterprises. By redistributing income, these measures substantially raised the living standards of many people in the OECD nations; and, by improving the skills, health and morale of their workers, as well as by helping to sustain aggregate demand, they also contributed to the increasing productiveness of their economies as a whole. At the same time, however, the cost of such gains had to be met by higher taxes, which reduced the earned disposable income of most households, or by greater government borrowing, which had similar effects through inflation on real income. In addition, the big increases in the size and variety of welfare and other government services and of those that private enterprises must provide, although in many cases desirable in themselves, began to weaken the incentives to work, save, invest, and innovate, thereby threatening to impair the very economic productiveness that makes high and rising living standards possible.

This relationship between desired gains and unanticipated costs and adverse consequences is the essence of the problem of welfare and efficiency as it has arisen in the OECD countries in recent years. In this chapter, the historical background of the problem is sketched, and its nature and present and prospective significance are viewed in a variety of analytical perspectives that will be explored in greater detail in subsequent chapters.

HISTORICAL BACKGROUND OF THE PROBLEM

The welfare/efficiency problem has its roots in some of the most basic social and cultural trends in Western civilization going back to the 11th century. Of central importance has been the gradually growing conviction that human beings are capable of understanding and controlling the processes of nature and society so as to obtain continually rising material and psychic satisfactions. This conviction played a major role in motivating the technical advances and institutional changes that culminated in the industrial revolution in the 19th century—that is, in the development and application of new production and management techniques yielding massive continuing increases in economic output on a scale previously
unknown in human history. In turn, this unprecedented expansion of resources made it possible for the first time in human experience to realize the aspirations for progressive improvements in the conditions of life that had hitherto seemed attainable, if ever in this world, only in some distant utopian future.

During the first half of the 19th century when laissez-faire economic theory and utilitarian political theory predominated, it was generally expected that the "invisible hand" of untrammeled market forces would not only produce continuing increases in resources but would also distribute them in ways that would bring "the greatest good to the greatest number." During the second half of the century, however, there was a gradual recognition that inherent "market imperfections" and disproportionate political power and economic capabilities were preventing certain groups of people from sharing adequately in the benefits of economic productiveness and would continue to do so unless remedial measures were adopted. Bismarck's pioneering social legislation in Germany was the first major step for assuring that the old, the sick and the disabled could maintain a minimum necessary level of consumption despite their inability to work.

In the course of the 20th century, further important changes have occurred in the productiveness of Western economic systems, in the size and variety of the gains expected by their people in consumption and welfare benefits, in the rationale governing the distribution of income, and in the agencies by which it is effected. Except for intervals of depression, the Western economies enjoyed continuing growth of output as successive technological and organizational advances raised productivity at compounded rates not only in industry but also in agriculture. These developments were particularly pronounced after World War II when the gross national products of OECD countries rose at unprecedented rates for nearly three decades—that is, until the great inflation and severe recession of the mid-1970s. The resulting abundance of resources during the postwar period both stimulated and made possible the satisfaction of expectations for increasing earned income and for expanding the volume and variety of welfare benefits and other government services.

At the same time, the conceptions of distributive justice that validated the division of the fruits of mounting productivity were also changing. Historically, these principles have both reflected and helped to maintain the institutional characteristics of the societies in which they prevailed. Thus, in the largely non-market agrarian economy and authoritarian social structure of Western society in the early middle ages, income distribution was conceived to be a function of inherited social status, with lord and serf each entitled to the share appropriate to his position in the social hierarchy. With the expansion of the market economy that began in the 11th century, the distributional principle was broadened to include the conception of income as a justified return for investment and risk-taking and as a merited reward for personal achievement, skill and effort. Also, the Judaeo-Christian ethic encouraged with greater or lesser effectiveness the distribution—or rather redistribution by religiously motivated individuals—of income for the relief of need. During the past 100 years, this personalistic concept of charity as a form of income redistribution has been progressively secularized and stripped of its voluntary element, eventuating in the contemporary welfare principle of the large-scale redistribution of income by impersonal government agencies in response to need.